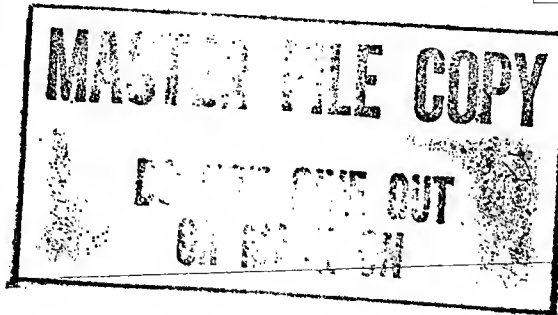




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Australia: The Fraser Government's Growing Political Problems

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An Intelligence Assessment

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Australia: The Fraser Government's Growing Political Problems

An Intelligence Assessment

This paper was prepared by [redacted]
[redacted] of the Office of East Asian Analysis.
It was coordinated with the National Intelligence
Council. Comments and queries are welcome and may
be addressed to the Chief, Southeast Asia Division,
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**Australia:
The Fraser Government's
Growing Political Problems**

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Key Judgments

*Information available
as of 15 December 1982
was used in this report.*

A staunch US ally, Prime Minister Malcolm Fraser faces serious political difficulties that threaten his government's hold on office. If elections were held now, the opposition Labor Party would win by a small margin, according to Australian public opinion polls. Despite this reading, speculation that Fraser might go to the polls within the next few months was revived in the Australian press recently because Fraser's Liberal Party won an unexpected victory in a byelection.

Public support for the Fraser government has eroded because of several scandals—including widespread tax evasion—and the sharp deterioration in Australia's economic performance, marked by the highest unemployment in 40 years, worsening inflation, and no real growth in 1982. Adding to the government's economic woes is a severe drought that is taking a heavy toll on agricultural production. Prospects for 1983 are equally grim, and we expect unemployment to top 10 percent early next year.

Labor will make economic mismanagement its major campaign issue in the next national election, which must be called by November 1983. A Labor victory is not assured, however. We believe much depends on whether Labor Party leader Bill Hayden contains longstanding factionalism in his party and cultivates for the party an image of moderation on issues the electorate deems important. For now, Hayden is doing both successfully, but Fraser is a tough, resilient politician who has shown in the past that he can come from behind.

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Australia: The Fraser Government's Growing Political Problems

The Pre-Election Setting

Prime Minister Malcolm Fraser must call national elections within the next year and no later than November 1983.¹ As recently as last September, prospects for an election in 1982 were good, according to the US Embassy and the Australian press.² Despite public opinion polls that showed Labor winning by a small margin, political observers in Australia assumed that Fraser would want to face the electorate before the domestic economy deteriorated further. However, mounting problems, including record unemployment, rising inflation, scandals surrounding the government, and Fraser's hospitalization and surgery for a back ailment in early November ended any prospect of elections in 1982.

Speculation about an early election revived in December, when the government won an unexpected victory in an important parliamentary byelection. According to the Australian press, Fraser may decide to capitalize on what he sees as the voters' rejection of the Labor Party. This scenario would have Fraser going to the polls after the Australian summer holiday season ends in late January.

Fraser's Multiplying Problems

The Scandals Surface . . . Reports of involvement by members of the Fraser government in several scandals have dominated the Australian media over the past

¹ Australian parliamentary elections are held triennially for the entire 125-seat House of Representatives and for half of the 64-seat Senate, whose members have six-year terms. Although elections are traditionally held between 1 October and 15 December, the Constitution provides the option of "early elections," which must precede the mandatory date by at least six months. Fraser led his Liberal-National Party coalition to unmatched victories in 1975 and 1977 and to a smaller but comfortable House majority in 1980. These victories helped to maintain a 33-year period of Liberal control, interrupted only by a Labor government under Gough Whitlam from 1972 to 1975.

² Nearly all the analysis in this assessment is based on US Embassy reports and on unclassified statistical material published by the Government of Australia and various international financial institutions.



Malcolm Fraser

Pictorial Parade ©

A 52-year-old wealthy rancher from Victoria state, Fraser has dominated the Australian scene since he became Prime Minister in late 1975. He strongly supports the United States on most international issues. His forceful personality has ensured him leadership of the Liberal Party and reelection twice to the prime-ministership, in 1977 and in 1980.

year, creating the impression of a government lurching from crisis to crisis. The most damaging case grew out of a Royal Commission set up to investigate charges of corruption and organized crime by the Labor Party-affiliated Federated Ship Painters and Dockers Union. Fraser had hoped to use the Commission's findings against Labor, but the investigation backfired when massive tax avoidance schemes involving several prominent Liberal Party members were uncovered.

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Before the full extent of government revenue losses became known, the Commission reported in early 1982:

This industry [the tax avoidance industry] has developed in Australia, particularly over the last five years, at a rate far in excess of any other industry and has brought with it profits comparable only to the heady days of the Victorian gold rush. . . . The amounts involved are very large indeed, amounting to many hundreds of millions of dollars per year or more. The impact on the community has been very serious. [redacted]

Current estimates by the government of the revenue lost during 1975-82 range from \$4-5 billion. The most publicized scheme—sending a firm to “the bottom of the harbor”—may have accounted for almost \$500 million lost during 1975-80, or about 10 percent of federal budget outlays in the fiscal year that began on 1 July 1982. [redacted]

The Commission's report touched off a controversial public debate at a time when inflation was pushing the average Australian into a higher tax bracket. The report noted, without citing names, that many of the tax avoidance practices could have continued only with the complicity of individuals in the Crown Solicitor's (the Attorney General's) Office. Even more damaging has been the revelation of federal government inaction, despite legal advice as early as 1977 that promoters of tax avoidance schemes were prosecutable. As a result, even the most flagrant abuses persisted until outlawed by a Taxation Offenses Bill in December 1980. [redacted]

Fraser wanted to use a proposed retroactive tax bill to recover lost tax revenues and to blunt Labor's charges of government mismanagement but ran into strong opposition from members of his own party. In late September, five of six Liberal Party state organizations opposed the retroactive legislation, which would make stockholders as well as promoters liable for back taxes.³ Liberal Party opposition to the bill in Parliament was so strong that it was withdrawn, amended,

³ The principal sticking point for many Liberal Party members is that both “witting and unwitting” stockholders as well as promoters would be liable for back taxes. [redacted]

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“Bottom-of-the-Harbor Schemes”

Tax avoidance in Australia uses a variety of approaches, almost all of which depend in some way on the absence of a capital gains tax. The widely publicized and, to the government, costly “bottom-of-the-harbor” schemes involved selling a corporation (including its cash assets) to a promoter, thus allowing stockholders to escape the 46-percent corporate profits tax. For example:

A firm with cash assets of \$1 million is sold to a promoter for \$960,000 (the difference being the promoter's fee). If the company had not been sold, it would have owed the 46-percent corporate tax, or \$460,000. By selling to the promoter, the stockholders avoid the tax on profits and thus receive a windfall gain of \$420,000, untaxable because there is no capital gains tax. [redacted]

Until this type of scheme was outlawed in 1980, the promoter disposed of whatever assets were left in the company after the sale and in many cases offered the corporate shell to lawyers and physicians to offset partnership tax liabilities. Frequently, the sham corporation had directors provided by the Federated Ship Painters and Dockers Union—often itinerants who could disappear if necessary or who had no assets the Tax Office could attach. The promoter's final step was to destroy company records, in some cases dumping them in Sydney Harbor, to throw the tax investigators off the track. [redacted]

and reintroduced in late October. The new version broadens the definition of promoter, making agents and brokers also open to prosecution. The amended bill is still being debated in Parliament, but we believe it will soon pass, with Labor's support. [redacted]

At the height of the furor over the Commission's report, another Royal Commission investigating a meat industry racket in which kangaroo meat was substituted for beef exported to the United States concluded that employees of the Ministry of Primary Industries were involved and faulted Minister Peter Nixon for not taking action earlier than he did. Fraser

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refused, however, to consider Labor's call for Nixon to resign. The incident, coming on top of a customs scandal earlier this year that resulted in the resignation of two Liberal Party Cabinet ministers, clearly added to the public's perception of government malfeasance and loss of administrative control. []

... *While the Economy Worsens.* Although public reaction to the scandals may die down before the next election, the economy, Fraser's major problem, is likely to deteriorate further in the months ahead. The country is suffering from the highest unemployment in 40 years (8.6 percent in November), rising inflation (a 13.5-percent annual rate in October), and a severe and widespread drought that is devastating agriculture. []

The economy has deteriorated with remarkable swiftness, largely because ongoing investment spending associated with the resources boom delayed the global recession's arrival in Australia. Depressed international commodity prices and high domestic interest rates have taken their toll this year, however, and industrial production has dropped by more than 10 percent since August 1981. The labor-intensive manufacturing and construction sectors have been hardest hit by job losses. Housing construction is at record low levels, largely because of high interest rates. Since mid-1982 mineral exploration expenditures have fallen, and we believe they may drop as much as 20 percent below last year's record high, as projects on the drawing boards are postponed or abandoned. In addition, Japan is reducing coal and iron ore imports below contracted levels and is hinting that purchases may be as much as 20 percent below anticipated levels for the remainder of the decade. The one bright spot continues to be oil exploration expenditures, which we believe will reach a new high this year. []

Business groups are threatening to increase layoffs to attempt to win concessions and financial assistance from the government, with varying success. The Confederation of Australian Industries (CAI) used this tactic to persuade Fraser to abandon his planned reduction in the level of import protection this year—an embarrassment because Fraser called for reducing international barriers to trade prior to his meeting with President Reagan last May in Washington. At the same time, however, Canberra refused to grant

Broken Hill Proprietary (BHP), Australia's largest private employer and only integrated steel company, all of the tax concessions or steel import quotas BHP requested. The company refused to guarantee that it would begin to modernize its facilities or reduce planned layoffs (over 8,500 in 1982 alone). According to the US Embassy, some businessmen—traditionally staunch supporters of the Liberal Party—are even beginning to speak favorably of Labor's publicly stated position on increased protection from imports to save jobs. []

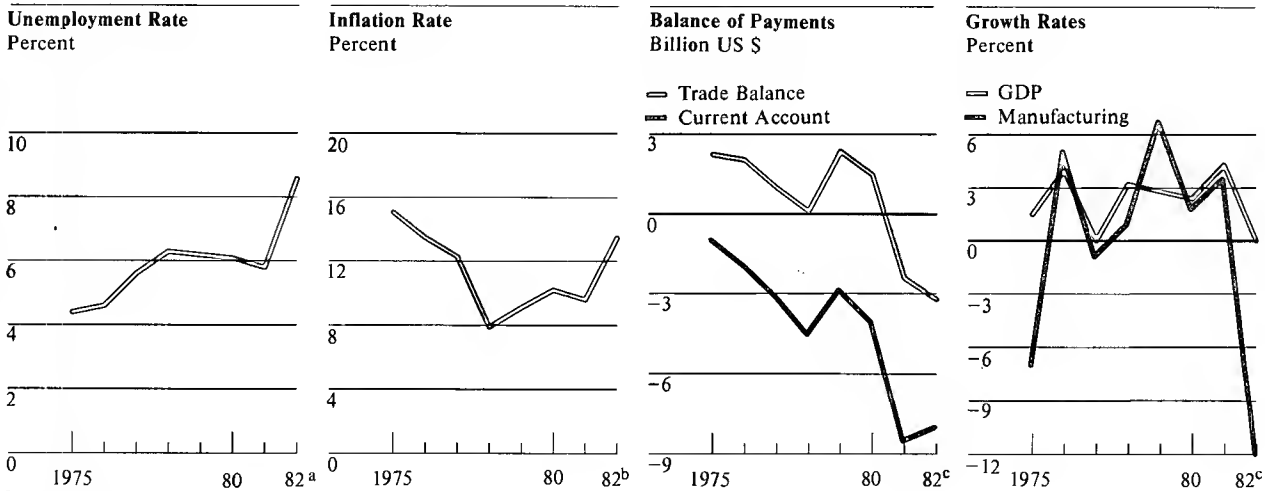
The driest growing season in 120 years is taking a heavy toll on agricultural production and will lower farm income and exports. We believe 1982 wheat production will be less than half 1981's 16 million tons. Other grains and beef production have also been hard hit, contributing to what we estimate will be a 50-percent drop in 1982 farm output. Among other effects, the poor production outlook has put the Fraser government in the embarrassing position of importing grain for the first time since 1957. []

We expect the economy to worsen over the next few months. Both official and unofficial Australian forecasters now project zero growth for the fiscal year that began 1 July. This follows the meager 1.9-percent growth last year. As a result, we believe unemployment will continue to rise and may top 10 percent early in 1983. We expect domestic interest rates, despite a recent decline, to remain relatively high in the near future because of growing budget deficits and the need to attract foreign capital to finance what Canberra forecasts will be a \$9 billion current account deficit. High interest rates will continue to retard construction and manufacturing investment. Furthermore, Australia's relatively high wages and lack of international competitiveness in manufacturing will moderate the impact of any recovery in international commodity prices. Nor can the Fraser government expect much relief from rising inflation in the next few months as higher taxes, increased government charges for social programs, the depreciated Australian dollar, and recent large wage gains won by militant unions push prices up. []

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Figure 1
Australia: Economic Indicators

Note change in scales



^a November 1982.

^b October 1982.

^c Estimated.

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The state of the economy gets constant attention in the Australian media, with a major financial newspaper taking the position that the country is on the verge of a depression. Even so, the financial press supports Fraser's refusal to consider large-scale jobs programs because of their effect on the federal budget deficit. In late October, 800 miners and steelworkers demonstrated outside Parliament for assistance for their ailing industries. A smaller group broke down the doors of Parliament and refused to leave until they had an audience with Fraser. Labor Party leader Bill Hayden interceded to arrange the meeting and then used the occasion to criticize Fraser's economic policies.

The Labor Party Offensive

The Labor Party has already launched its election campaign to take advantage of Fraser's considerable problems. In our judgment, Labor's strategy rests on three themes—Fraser's alleged economic mismanagement, government impropriety, and the need to project the image of Labor as a moderate and responsible party.

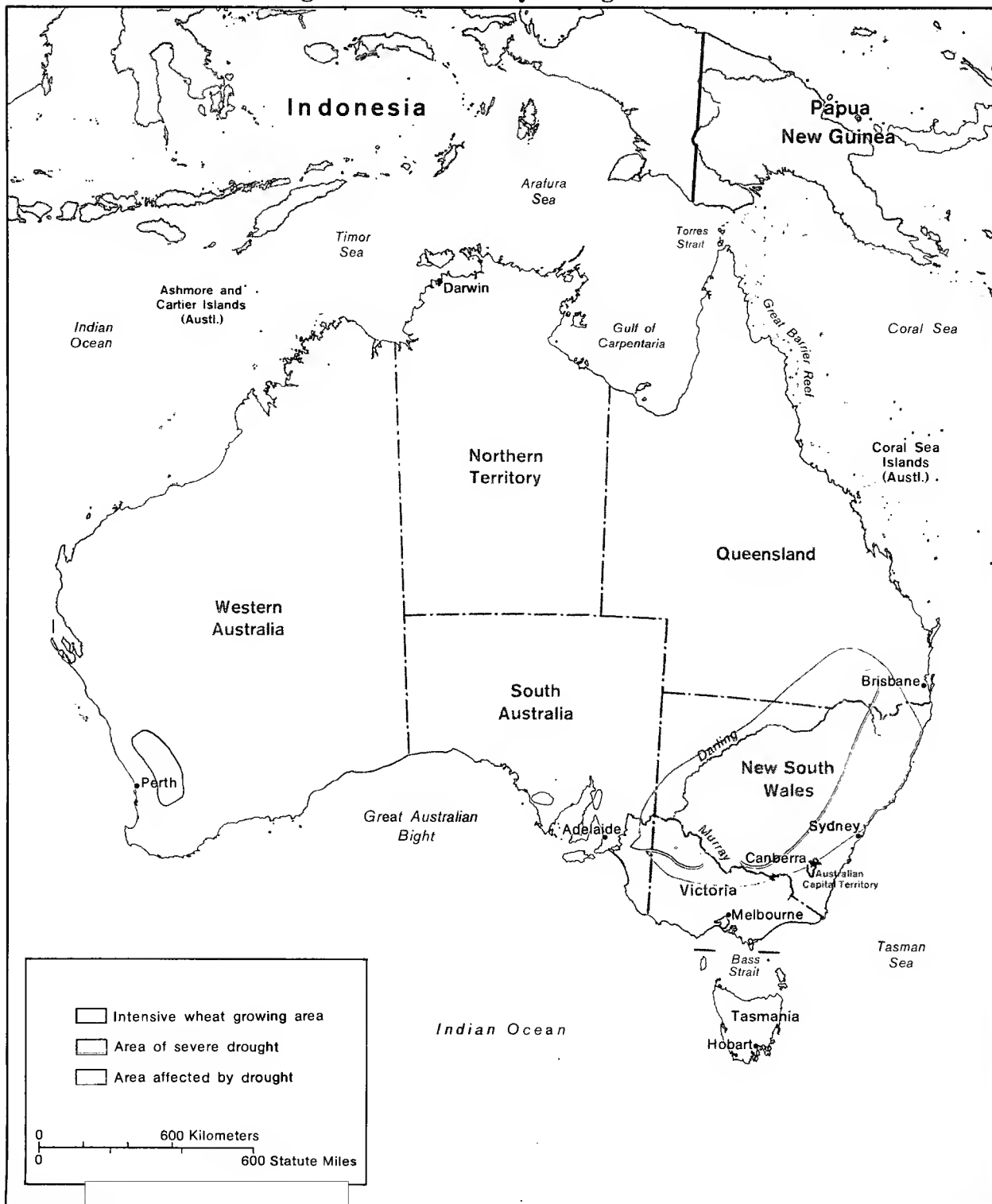
Labor's main line of offense is the charge of economic mismanagement. Opposition leader Hayden is castigating Fraser for economic policies that have allowed unemployment and inflation to reach "catastrophic proportions." In addition to putting the government on the defensive, Labor hopes to counter earlier charges that it has no solutions to the country's economic difficulties by introducing an "Emergency Rescue Plan" and the "Hayden Housing Plan." Both proposals call for increasing government expenditures on salaries, social programs, and housing construction. In response to criticism from Treasurer John Howard that the proposals are inflationary, Labor has put forward a wide-ranging incomes policy that would require the cooperation of labor unions. It would limit wage increases while imposing controls on other incomes and on prices.

In keeping with Australia's tradition of fierce, adversarial politics, Labor is also attacking the integrity of the government. Hayden describes the Fraser administration as the most scandal ridden in Australia's

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Figure 2
Australia: Wheat Growing Areas Affected by Drought



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William Hayden

Jeanette Harris ©

Labor Party leader since late 1977, 49-year-old Hayden is a self-made man from a Queensland working-class background. He is an economist by training. Although essentially a political moderate, Hayden has taken positions on nuclear issues and US-shared defense facilities in Australia that would create problems for the United States should Labor come to office in the next election.

history. He claims three Australians with knighthoods were involved with organized crime and that tax avoidance laws were not enforced because senior Liberal Party members were benefiting. Hayden has repeatedly called for the resignations of Attorney General Peter Durack and Treasurer Howard for their alleged knowledge and coverup of wrongdoing.

Labor is making a conscious effort to reassure the public about the party's moderate position on major issues. Still plagued by memories of the turbulent and often controversial years of Labor government under Gough Whitlam, Labor is taking pains to change its image. Hayden has been courting the business community, promising that a Labor government of the

1980s will not resemble the free-spending Whitlam years. The party has also modified its stance on a number of provocative issues: it retreated from a previously declared intention to enact a capital gains tax, and it reaffirmed support of the ANZUS alliance. Wary of stirring up controversy, Labor leaders have refused to adopt the party left wing's position on abortion, which would require Labor members in Parliament to support liberalization of the abortion law regardless of their personal convictions. According to the US Embassy, the party has also successfully dissociated itself from the Federated Ship Painters and Dockers Union, which was involved in recently publicized criminal activities.

According to the Australian press, Fraser wants to make Labor Party factionalism an issue in the Liberal campaign. To counter this threat, Labor leaders have been busy glossing over internal friction in order to present an image of unity and strength. Thus far, Hayden has been fairly successful, exhibiting particular skill in keeping Labor's often divisive left wing under control. He has been somewhat less successful vis-a-vis Bob Hawke, who narrowly lost his bid to lead the party during the party convention last July. Hawke has given his full public support to Hayden, and his personal style and media savvy have contributed enormously to Labor's recent appeal among the electorate. But recent press reports suggest that Hawke may consider challenging Hayden again. According to the US Embassy, this possibility has alarmed Labor leaders, who believe such a move would indicate party weakness and give Fraser the political ammunition he needs.

Labor's offensive has gained the party strong standing in recent public opinion polls. Even though Hayden's economic proposals do not offer much more than a repudiation of the Fraser government's policies, the US Embassy believes the Australian people probably will support any plan that attempts to remedy the current state of economic affairs rather than accept the government's "steady as she goes" policies.

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Bob Hawke

Camera Press ©

Australia's best known and most popular Labor Party and trade union figure, 52-year-old Hawke last July made an unsuccessful bid for leadership of the Labor Party. The son of a Congregational minister, he earned his national reputation as President of the Australian Council of Trade Unions, federal President (titular head) of the Labor Party, and member of Parliament. His expertise in labor negotiations, popular image, and moderate socialist politics make him a powerful force in the Labor Party and a figure to watch.

Fraser Fights Back

Fraser is a tough, resilient politician who has a history of rallying public support very late in a campaign. Public opinion polls, for example, showed Labor ahead just three days before the 1980 election.

Although Fraser's first strategy for dealing with the tax avoidance scandals—retroactive legislation—created even more problems in his own party, his adherence to this principle has won grudging admiration from the public and even from some Labor members of Parliament, according to the Australian press. Recent indictments of “bottom-of-the-harbor” promoters and broadening the scope of liability for back

taxes have also strengthened Fraser's position. If no new difficulties arise, we believe the worst effects of the scandals are over.

Fraser is also having some success mending fences in the Liberal Party. In October he named former Foreign and Industrial Relations Minister Andrew Peacock to replace the ailing Minister of Industry and Commerce. Peacock, who resigned from the Cabinet in 1981 after charging Fraser with undercutting his authority, made a bid for Liberal Party leadership early this year but lost decisively. We believe the appointment of Peacock, a smooth media performer, will improve the government's standing in public opinion polls.

Fraser has responded to the drought with an extensive relief program. In addition to efforts to buy foreign grain and expand markets for beef exports, the Cabinet has approved subsidizing interest rates over 12 percent and subsidizing the cost of fodder. Other measures under consideration include subsidies for water transport and for the cost of new wells.

The government's drought-relief program has gotten mixed reviews. The Labor Party argues that current relief measures are grossly inadequate, while fiscal conservatives attack the \$350 million program as contrary to Fraser's avowed policy against inflation. In the wake of the recent scandals, the Australian press is openly speculating about the possibilities for the abuse of relief funds.

Fraser has little room to maneuver on the economy. Concern over growing federal budget deficits, the need to pursue a high-interest-rate policy to maintain foreign capital inflows, and his view that slowing inflation has the highest priority are constraints. The budget for the fiscal year that began on 1 July projected a deficit of only \$1.6 billion because estimates of unemployment compensation, drought-relief costs, and tax revenue were highly unrealistic. Current estimates project a deficit exceeding \$4 billion. We believe a deficit of this size makes it unlikely that Fraser will support large increases in government

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Andrew Peacock

Jeanette Harris ©

The son of a prominent businessman, 43-year-old Peacock was first elected to Parliament in 1966 and has held a variety of influential positions in government. As Minister of Foreign Affairs, Peacock clashed openly with Fraser, leading to his temporary retreat from politics earlier this year. Matters were smoothed over in October 1982 when Peacock was named Minister of Industry and Commerce. He is considered a strong contender for leadership of the Liberal Party. [redacted]

spending on jobs programs. According to a recent study cited in the Australian press, a \$1 billion jobs program would reduce the unemployment rate by only 1 percent. To reduce the unemployment rate to what Australians would consider a reasonable level, about 5 percent, would cost Canberra some \$3.5 billion above the projected deficit. [redacted]

Instead, the Fraser government has recently adopted an economic recovery program centered on a national "wage pause." In early December, Canberra persuaded the six state premiers to join in a public-sector (state and federal employee) wage freeze, thus borrowing the wage restraint plank from Labor's program without the accompanying controls over prices

Will Unions Accept a Cut in Real Wages?

The Fraser government maintains that recent wage settlements are a key ingredient in Australia's reduced international competitiveness and argues that workers must accept a cut in real (inflation-adjusted) wages to prevent unemployment from rising further. According to government statistics, average wage settlements over the past year rose 18 percent, far in excess of the 11-percent inflation rate. [redacted]

Until recently, government monetary policy—anti-inflationary rhetoric notwithstanding—has allowed wage increases to be passed on in the form of higher prices in order to maintain employment. We believe Fraser has now decided to use the recession to try to break the wage-price spiral. In addition to the public-sector wage freeze, Canberra is fully supporting employer groups in their efforts to extend existing contracts with no wage hikes. [redacted]

Although union leaders continue to oppose the "wage pause," we believe the rank and file are increasingly concerned with job security and will not support strikes for higher wages. Therefore, we believe wage settlements in the next few months will be lower than in the past year, thus moderating inflation. In fact, "give backs" in the form of lower wage settlements and reduced hours are increasing, especially in small businesses. Nonetheless, we expect wage-push inflation to reappear as soon as world demand for Australian exports revives and is translated by Australian unions into higher across-the-board wage increases. [redacted]

and other incomes. The government plans to use the estimated savings of \$300 million to fund a jobs program. It is also taking administrative measures to limit imports, such as speeding up the processing of import dumping cases, to aid Australian industry. [redacted]

We do not believe the recovery program is large enough to have a major impact on employment. Furthermore, the public-sector wage freeze faces

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problems. Union leaders who had expressed willingness to go along with a six-month wage freeze, followed by a catchup wage increase, are now saying that the 12-month freeze proposed by Canberra is unacceptable and are predicting public employee strikes. In addition, the three state premiers who belong to the Labor Party agreed to only a six-month freeze and did not rule out a catchup wage increase.

[REDACTED]

Fraser is counting on the public sector's example to encourage the private sector to hold down wage increases but plans no legislation to impose a freeze, according to the US Embassy. Rather, the government hopes to convince most private sector employers to resist union demands for full cost-of-living adjustments. This strategy has produced mixed results. A recent oil industry contract provided for wage and benefit increases exceeding 15 percent, but this industry's wage settlements frequently do not set the trend for other industries. More important as a pacesetter is the metals industry settlement currently under negotiation. Canberra is strongly supporting management's proposal for a six-month contract extension with no wage increases, and we believe this is forcing labor to back off on its demands. By mid-December, for example, the Australian Council of Trade Unions had abandoned its public position of maintaining real wages because union leaders found the rank and file more concerned with job security than with taking industrial action, according to the US Embassy and Australian press reports. As a result, we believe the government's "wage pause" has a reasonably good chance of succeeding if Canberra wins the full cooperation of the private sector.

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